

Innocent Spouse Relief, Separation of Liability, and Equitable Relief

PURPOSE: The purpose of this Special Notice is to describe new legislation that allows the Commissioner of Revenue Services to grant relief from joint and several liability for Connecticut income tax, interest, penalties and other amounts due for the taxable year.

EFFECTIVE DATE: Effective for tax liabilities arising after May 27, 1999, and any liability arising on or before that date, if the liability remains unpaid on that date.

STATUTORY AUTHORITY: 1999 Conn. Pub. Acts 48, §4.

BACKGROUND: Taxpayers who file a joint Connecticut income tax return are jointly and severally liable for the income tax, interest, penalties, and other amounts due (hereinafter references to “tax” include interest, penalties, and other amounts due), on their joint return. This means that one individual may be liable for the entire amount of tax due on the joint return even if that individual did not earn any income for the taxable year or was unaware of errors (intentional or otherwise) reported on the return. This is true even if the individual has subsequently become divorced from the other joint filer.

Under the new law, a taxpayer may request relief from joint and several liability. Three types of relief are available:

- Innocent spouse relief
 - Separation of liability
 - Equitable relief
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INNOCENT SPOUSE RELIEF: Innocent spouse relief allows the requesting individual (“innocent spouse”) to be relieved of a deficiency to the extent the liability is attributable to an understatement of tax caused by an erroneous item of the non-requesting individual. In these situations, the Department of Revenue Services (DRS) must collect the outstanding liability from the non-requesting individual (“other spouse”).

Relief with respect to a deficiency will be granted if the following requirements are met:

- A joint return was filed by the innocent spouse and the other spouse for the taxable year for which relief is requested;
- There is an understatement of tax attributable to erroneous items of the other spouse;
- In signing the return, the innocent spouse did not know, and had no reason to know, that there was an understatement of tax (If an innocent spouse fails to meet this condition, he or she may still qualify for partial innocent spouse relief. See *Partial Innocent Spouse Relief* below.);
- Taking into account all the facts and circumstances, it is inequitable to hold the innocent spouse liable for the deficiency in tax for the taxable year attributable to the understatement or portion of the understatement; and
- The innocent spouse elects to apply for relief no later than two years after the date of the Commissioner’s first collection activity after May 27, 1999, with respect to such individual.

Partial Innocent Spouse Relief: If all of the requirements are met except that the innocent spouse knew, and had reason to know, that there was an understatement of tax, but did not know the *extent* of the understatement, then the innocent spouse is eligible for relief to the extent that the liability is attributable to the portion of the understatement of which such individual did not know or had no reason to know.

Erroneous items. As used in this special notice, “erroneous items” are either of the following:

- Unreported income. This is any gross income item received by the other spouse that is not reported and that affects the Connecticut income tax liability of the spouses.
- Incorrect deduction, credit, or basis. This is any improper deduction, credit, or property basis that is claimed by the other spouse and that affects the Connecticut income tax liability of the spouses.

Understatement of tax. An understatement of tax is generally the difference between the total amount of Connecticut income tax that should have been shown on the spouses' Connecticut income tax return and the amount of Connecticut income tax that was actually shown on the spouses' Connecticut income tax return.

Innocent spouse relief may generate a refund.

Facts and Circumstances Used to Determine Whether it is Inequitable to Hold the Requesting Spouse Liable for the Deficiency: DRS will consider all of the facts and circumstances in determining whether it is inequitable to hold the requesting individual responsible for the understatement. DRS may determine that it is inequitable to hold the requesting individual liable for the deficiency if the requesting individual:

- Did not receive any significant benefit from the understatement of tax; or
- Was later divorced from or deserted by the non-requesting individual.

An individual can receive a significant benefit either directly or indirectly. For example, if the non-requesting individual did not report \$10,000 of income on the joint return, and shared it with the requesting individual, the requesting individual is directly benefiting from the understatement of tax. The requesting individual is indirectly benefiting from the unreported income if the non-requesting individual used such income to pay extraordinary household expenses.

SEPARATION OF LIABILITY: Separation of liability allows the requesting individual to allocate a deficiency between joint filers to the extent the liability is attributable to an understatement of tax caused, in part, by an item of the non-requesting individual.

Relief with respect to a deficiency allocable to the non-requesting individual will be granted if all of the following requirements are met:

- A joint return was filed by the requesting individual and the non-requesting individual for the taxable year for which relief is requested;
- There is an understatement of tax due, in part, to the non-requesting individual;
- At the time relief is requested, the requesting individual is no longer married to, is legally separated from, or has not been a member of the same household as the non-requesting individual for at least 12 months ending on the date the request is filed;

- The requesting individual applies for relief no later than two years after the date of the Commissioner's first collection activity after May 27, 1999, with respect to such individual; and
- The liability remains unpaid at the time relief is requested.

If separation of liability with respect to a deficiency is granted, the requesting individual will be able to allocate the deficiency between the joint filers. Any item giving rise to the deficiency shall be allocated as if the individuals had filed separate returns for the taxable year. The requesting individual has the burden of proof with respect to establishing the portion of any deficiency allocable to such individual.

If an exemption under Conn. Gen. Stat. §12-702 or a credit under Conn. Gen. Stat. §12-703 would be disallowed in its entirety solely because a separate return is filed, the disallowance will be disregarded and the item will be computed as if a joint return had been filed and then allocated between the joint filers appropriately. Also, if the liability of a child of a taxpayer is included on a joint return, the liability will be disregarded in computing the separate liability of either joint filer and such liability will be allocated appropriately between the joint filers.

Separation of liability is subject to three limitations:

1. Relief is not available if the Commissioner demonstrates that assets were transferred between individuals filing a joint return as part of a fraudulent scheme.
2. Relief is not available if the Commissioner demonstrates that the requesting individual had actual knowledge, at the time the spouse signed the return, of any item giving rise to the deficiency or portion thereof which is not allocable to such individual (unless the individual signed under duress).
3. The portion of the deficiency for which the requesting individual is liable will be increased by the value of any "disqualified asset" transferred to such individual by the non-requesting individual.

A "disqualified asset" means any property or right to property transferred to the requesting individual with respect to a joint return by the non-requesting individual filing the joint return, if the principal purpose of the transfer was the avoidance of tax or payment of tax.

Separation of liability relief will not generate a refund.

EQUITABLE RELIEF: Equitable relief allows the requesting individual to be relieved of a deficiency relating to an understatement of tax or a liability relating to an underpayment of tax, or any portion of either. Thus, it is the only provision that provides relief from self-assessed tax. It is used to prevent inequitable results that cannot be achieved statutorily under the innocent spouse and separation of liability provisions.

A requesting individual must meet all of the following conditions to be eligible to be considered for equitable relief:

- A joint return was filed by the requesting individual and the non-requesting individual for the taxable year for which relief is requested;
- Relief is not available to the requesting individual under the *innocent spouse* or *separation of liability* provisions;
- The requesting individual applies for relief no later than two years after the date of the Commissioner's first collection activity after May 27, 1999, with respect to such individual;
- The liability remains unpaid at the time relief is requested;
- No assets were transferred between joint filers as part of a fraudulent scheme by such individuals;
- There were no "disqualified assets" transferred to the requesting individual by the non-requesting individual; and
- The requesting individual did not file the joint return with fraudulent intent.

A requesting individual satisfying all of the requirements set forth above may be relieved of all or part of the liability if, taking into account all the facts and circumstances, it is inequitable to hold the requesting individual liable for all or part of the liability.

Equitable relief will not generate a refund.

Circumstances Under Which Equitable Relief will Ordinarily be Granted: Where a liability reported on a joint return is unpaid, equitable relief will ordinarily be granted if all of the following requirements are met:

- At the time relief is requested, the requesting individual is no longer married to, or is legally separated from, the nonrequesting individual, or has not been a member of the same household as the nonrequesting individual at any time during the 12-month period ending on the date relief was requested;
- At the time the return was signed, the requesting individual had no knowledge or reason to know

that the tax would not be paid. The requesting individual must establish that it was reasonable for the requesting individual to believe that the nonrequesting individual would pay the reported liability. If the requesting individual would otherwise qualify for relief except for the fact that the requesting spouse had no knowledge or reason to know of only a portion of the unpaid liability, then the requesting individual may be granted relief only to the extent that the liability is attributable to such portion; and

- The requesting individual will suffer economic hardship if relief is not granted.

Relief will only be available to the extent that the unpaid liability is allocable to the nonrequesting individual. In the event that the joint return is or has been adjusted to reflect an understatement of tax, relief will only be available to the extent of the liability shown on the return prior to any adjustment.

Factors Used in Determining Whether to Grant Equitable Relief Where Requesting Individual is Eligible to be Considered for Equitable Relief but the Circumstances Under Which Equitable Relief Will Ordinarily be Granted are Not Present:

The following is a partial list of the factors that will be taken into account in determining whether to grant full or partial equitable relief. No single factor will be determinative of whether equitable relief will or will not be granted in any particular case. Rather, all factors will be considered and weighed appropriately.

Factors weighing in favor of granting equitable relief include:

- The requesting individual is separated (whether legally separated or living apart) or divorced from the nonrequesting individual;
- The requesting individual would suffer economic hardship if relief from the liability is not granted;
- The requesting individual was abused by the nonrequesting individual, but such abuse did not amount to duress;
- In the case of a liability that was properly reported but not paid, the requesting individual did not know and had no reason to know that the liability would not be paid. In the case of a liability that arose from a deficiency, the requesting individual did not know and had no reason to know of the items giving rise to the deficiency;
- The nonrequesting individual has a legal obligation pursuant to a divorce decree or agreement to pay the outstanding liability. However, this will not be a factor weighing in favor of granting relief if the requesting individual knew or had reason to know, at the time the divorce decree or agreement was entered into, that

the nonrequesting individual would not pay the liability;

- The liability for which relief is requesting is solely attributable to the nonrequesting individual; and
- The Internal Revenue Service has previously granted relief to the requesting spouse for the same liability.

Factors weighing against granting equitable relief include:

- The unpaid liability or item giving rise to the deficiency is attributable to the requesting spouse;
- The requesting individual knew or had reason to know of the item giving rise to the deficiency or that the reported liability would be unpaid at the time the return was signed;
- The requesting individual has significantly benefited (beyond normal support) from the unpaid liability or items giving rise to the deficiency;
- The requesting individual will not experience economic hardship if relief from the liability is not granted;
- The requesting individual has not made a good faith effort to comply with Connecticut income tax laws in the taxable years following the taxable year or years to which the request for relief relates;
- The requesting individual has a legal obligation pursuant to a divorce decree or agreement to pay the liability; and
- The Internal Revenue Service has previously denied relief to the requesting spouse for the same liability.

HOW TO REQUEST RELIEF: To request relief, file **Form CT-8857, Request for Innocent Spouse Relief (And Separation of Liability and Equitable Relief)**. When DRS receives the request, collection activities concerning the specified taxable year(s) will cease until a determination regarding the request has been rendered.

If the requesting individual filed federal Form 8857, *Request for Innocent Spouse Relief (And Separation of Liability and Equitable Relief)*, for the same taxable year, DRS will wait for the Internal Revenue Service to make a determination regarding the request.

Subsequently, DRS will review the federal determination and calculate the understatement or underpayment of tax (if any) for Connecticut income tax purposes.

If the requesting individual did not request federal relief for the same taxable year, DRS will make an independent determination of relief based on the factors set forth herein and calculate the

understatement or underpayment of tax (if any) for Connecticut income tax purposes.

A requesting individual must file **Form CT-8857** no later than two years after the date of the Commissioner's first collection activity after May 27, 1999, with respect to such individual.

The Commissioner is required to notify the nonrequesting individual of the filing of **Form CT-8857** and provide an opportunity for such individual to participate in any administrative proceeding relating to the determination.

PROTESTS: After making a determination, the Commissioner will mail notice of the proposed determination to the requesting individual. The notice will set forth the Commissioner's findings of fact and the basis of the determination in each case decided in whole or in part adversely to the requesting individual. Sixty days after the date on which the notice of proposed determination is mailed, such notice shall constitute a final determination, except for such amounts as to which the requesting individual has filed a written protest.

On or before the sixtieth day after the mailing of the proposed determination, the requesting individual may file a written protest against the proposed determination setting forth the grounds for the protest. If such a protest is filed, the Commissioner will reconsider the proposed determination and, if requested, may grant or deny the requesting individual or the requesting individual's authorized representative an oral hearing.

Subsequently, the Commissioner will mail notice of the determination and set forth the findings of fact and the basis for where such determination is in whole or in part adverse to the requesting individual.

The notice of determination will be final upon the expiration of one month from the date on which the Commissioner mails the notice to the requesting individual unless within such period such individual seeks judicial review of the Commissioner's determination pursuant to Conn. Gen. Stat. §12-730.

EFFECT ON OTHER DOCUMENTS: None.

EFFECT OF THIS DOCUMENT: A Special Notice is a document that announces a new policy or practice in response to changes in State or Federal laws or regulations or to judicial decisions. A Special Notice indicates the Department's informal interpretation of Connecticut tax law and may be referred to for general guidance by taxpayers or tax practitioners.

FOR FURTHER INFORMATION: Call the Department of Revenue Services during business hours, 8:00 a.m. to 5:00 p.m., Monday through Friday:

- **1-800-382-9463** (toll-free within Connecticut), or
- **860-297-5962** (from anywhere).

TTY, TDD, and Text Telephone users only may transmit inquiries 24 hours a day by calling 860-297-4911.

FORMS AND PUBLICATIONS: Forms and publications are available all day, seven days a week:

- **Internet:** Preview and download forms and publications from the DRS Web site: **www.drs.state.ct.us**
- **DRS TAX-FAX:** Call **860-297-5698** from the handset attached to your fax machine and select from the menu; or
- **Telephone:** Call **860-297-4753** (from anywhere), or **1-800-382-9463** (toll-free within Connecticut) and select **Option 2** from a touch-tone phone.

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